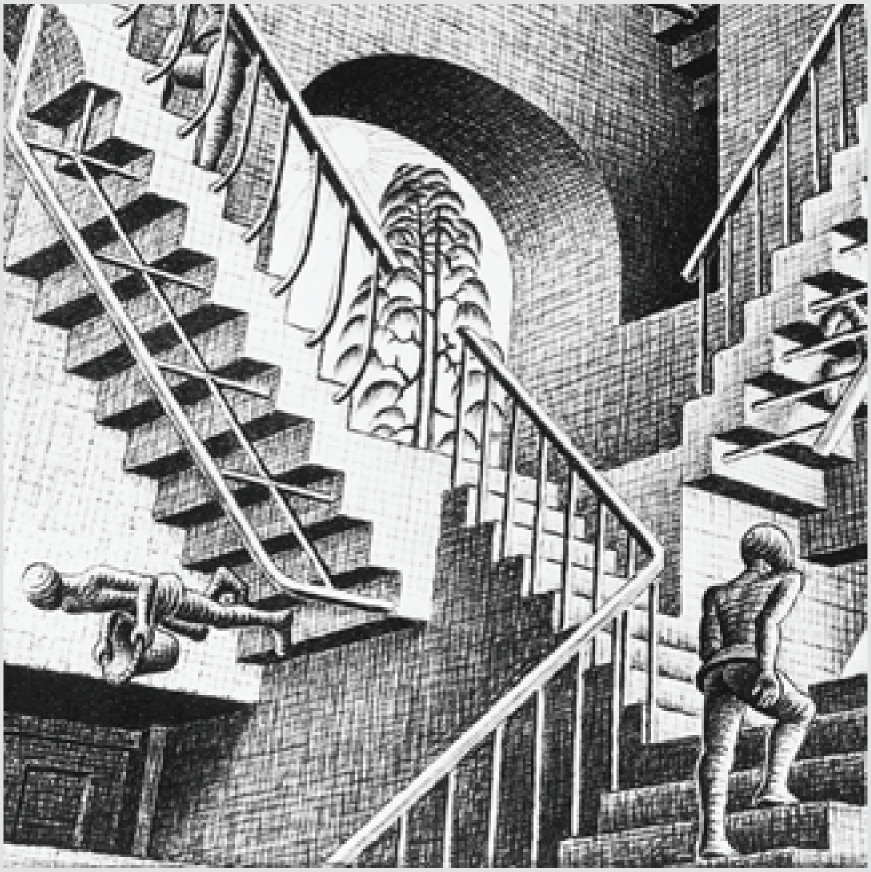
1 Inequality of what? Inequality between whom?



[There is a] false dichotomy between outcome and opportunity inequality. The two are but opposite sides of the same coin. Hence, development policy focusing on inequality reduction must address both.

1.1. Introduction

What are the dimensions of inequality that matter for human well-being? How are inequalities in different dimensions of well-being distributed among individuals, households and specific groups within a population? These two questions have long been central to discussions of inequality in development discourse and policy.

By now, it is well established that human well-being is multi-dimensional.[1] Recent approaches see well-being as "arising from a combination of what a person has, what a person can do with what they have, and how they think about what they have and can do" (IDS, 2009). In other words, well-being has three core dimensions: the material that emphasizes practical welfare and standards of living; the relational that emphasizes personal and social relations; and the subjective that emphasizes values and perceptions. The three dimensions are interlinked and their demarcations are highly fluid (McGregor, 2007; Sumner and Mallett, 2013).

Despite the inherent multidimensionality of human well-being, development theory has largely been concerned with inequality in the material dimension — that is, with inequalities in standards of living such as inequalities in income/wealth, education, health and nutrition (Conceicao and Bandura, 2009). Much of this discussion has boiled down to a debate between two perspectives: the first is primarily concerned with the **inequality of outcomes** in various material dimensions of human well-being, such as the level of income or level of educational attainment; and the second with the **inequality of opportunities** (that matter for equitable outcomes), such as unequal access to employment or education.

Unequal outcomes, particularly income inequality, it is argued, play a key role in determining variations in human well-being. This is made evident by the strong association between income inequality and inequalities in health, education and nutrition (WHO, 2008).[2] Moreover, when the privileged exercise sufficient political control and influence, and when this kind of influence affects job availability or access to resources, then income inequality compromises the economic, political and social lives of those less privileged and limits the opportunities they have to secure their well-being (Birdsall, 2005).

If higher incomes provide people with opportunities to secure their well-being and to get ahead in life, then a person's initial income matters. Initial income inequality can positively or negatively affect the likelihood and speed with which a person can get ahead in life. Put differently: to have meaningful equality of opportunity, income inequality needs to be moderated so that people start their lives from roughly equal starting points.

The second perspective[3] emphasizes the fact that certain individuals and groups face consistently inferior opportunities — economic, political and social — than their fellow citizens. Individuals, it is argued, can hardly be held responsible for the circumstances of their birth: their race, sex or urban or rural location. Yet these predetermined background variables make a major difference for the lives they lead. In other words, the opportunities that people have to reach their full human potential are vastly different from the outset through no fault of their own. Not surprisingly, unequal opportunities lead to unequal outcomes (World Bank, 2006).

Specifically, the inequality of opportunity is that part of the inequality of outcomes (such as income) attributed to differences in individual circumstances such as race, gender or ethnicity. The rest is attributed to differences in 'talent and effort'. In other words, this perspective is primarily concerned with the fairness of processes that lead to outcomes.

A key difference between the two perspectives hinges on the direction of causality between outcomes and opportunities. Will higher incomes lead to improved opportunities or will greater opportunity lead to improved outcomes in human well-being? This, however, is a false dichotomy, since outcomes and opportunities are in fact highly interdependent. Equal outcomes cannot be achieved without equal opportunities, but equal opportunities cannot be achieved when households have unequal starting points.

This chapter reviews different approaches in the development literature with respect to the inequality of outcomes and that of opportunities. It is argued that frameworks that focus on the inequality either of outcomes or of opportunities by themselves are inadequate for addressing inequality in human well-being, given the interdependency between opportunities and outcomes and how this is played out in the context of a market economy.

Even as income inequality is a critical factor in determining other non-income outcomes of well-being (such as health, nutrition and education), it is not the only factor driving inequalities in non-income outcomes (Sen, 2003). Research has consistently pointed to the role of institutions (for example, inefficient or ineffective service delivery systems), governance failures (such as corruption and absence of the rule of law) and public policy shortcomings (reflected, for instance, in public expenditure biases that favour the privileged) as key drivers of inequalities in non-income dimensions of material well-being (Deaton, 2001; Marmot, 2005; UNICEF 2010).

Frameworks that focus on the inequality either of outcomes or of opportunities by themselves are inadequate for addressing inequality in human well-being, given the interdependency between opportunities and outcomes and how this is played out in the context of a market economy.

Furthermore, this perspective is unable to explain why unequal outcomes and opportunities persist for specific groups within the population. Even after controlling for observable differences such as level of education, type of employment, sector of employment and demographic variables such as age, gender, racial and ethnic income, disparities remain persistent (Darity et al. 2010; Ñopo and Ramos, 2011; Seguino, 2008). In Latin America, for instance, women still earn almost 20 percent less than men and this income gap persists despite the fact that females have outperformed men in educational achievements. Furthermore, on average, ethnic minorities (indigenous and Afro-descendant populations) experience an unexplained wage differential of 13 percent (Ñopo, 2012).

The second perspective holds that, without equal opportunities, systemic patterns of discrimination and social exclusion prevent disadvantaged groups or individuals from accessing resources, markets and public services. However, simply providing equal opportunity may not be enough to improve the inequality of outcomes for two reasons.

First, high-income inequality is itself likely to be a sign that processes such as economic growth are not equitable. This perspective underplays the critical importance of structural and economic growth processes that are needed to transform equal opportunity into more equitable outcomes. Opportunities require an appropriate environment to be transformed into just outcomes.

Second, despite an explicit focus on the ‘fairness’ of processes that determine material outcomes, equal opportunity perspectives are unable to explain why discriminatory behaviour appears intransigent even where there is formal equality. Why do inter-group inequalities (of outcomes and opportunities) persist even in situations where overt discrimination is illegal and the provision of basic services universal?

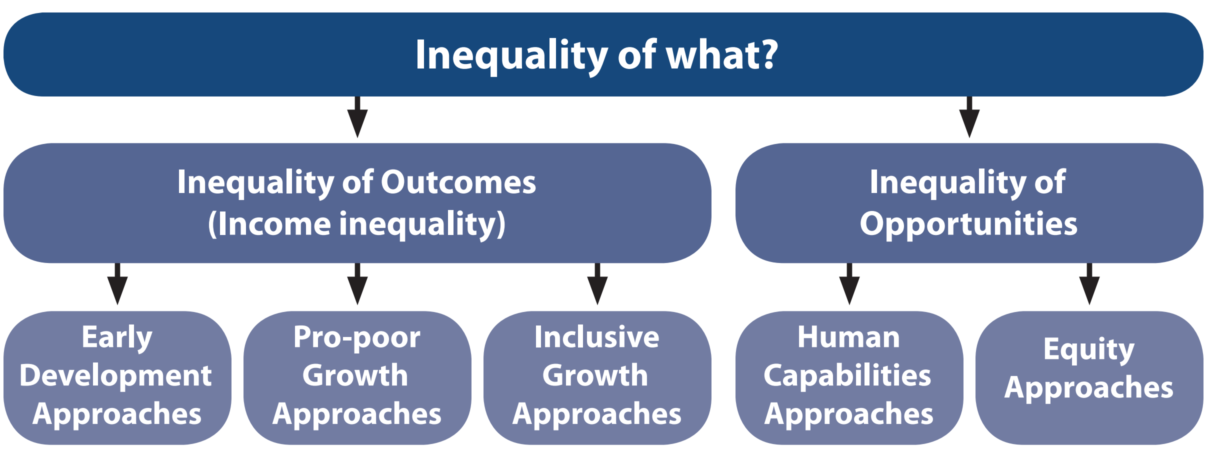
It is time to move the development discourse of inequality beyond current discussions of outcomes and opportunities. Nowhere is this more important than in its implications for development policy. If the outcomes and opportunities that matter for human well-being are interdependent, then policy measures need to address inequalities of both. The exact policy mix adopted needs to be tailored and sequenced to respond to the specific needs and circumstances of each country and depends on the type of inequality that may be more pervasive.

The next section reviews various approaches in the development literature with respect to the inequality of outcomes, focusing principally on income inequality. Section two reviews frameworks that address the inequality of opportunity. Section three provides the rationale for why it is important to move beyond the false dichotomy of inequality of outcomes or opportunities, and the policy implications thereof. The conclusion follows.

Development frameworks that examine income inequality have a long history beginning with the growth and distribution literature of the 1950s (Lewis, 1954; Kuznets, 1955). The principal concern of these early approaches was the nature of the relationship between economic growth and income distribution. By the late 1990s, however, frameworks addressing income inequality were more concerned with the role of inequality for poverty reduction. More recently, though, the pendulum appears to have shifted, with the literature focused on the interplay among growth, inequality and poverty. Three development frameworks addressing income inequality will be examined: the early development approaches; pro-poor growth frameworks; and inclusive growth approaches.

Section two examines two specific approaches that have informed much of the discourse on the inequality of opportunity. The first is the human capability approach, which has profoundly shifted the development discourse of inequality and influenced much of the subsequent literature on inequality, including that of gender and horizontal inequalities.[4] The second is the equity approach, which, too, has been inspired by the human capability perspective. Even as there are important differences between the two approaches,[5] there are also underlying similarities, which is why both prioritize a focus on the inequality of opportunity as opposed to outcome inequality.

Figure 1.1. Inequality of outcome and opportunity: development approaches



1.2. Income inequality

1.2a. Early development approaches

In the early days of development theory, income inequality was typically examined in the context of a long-term growth trajectory envisaged for developing nations (Lewis, 1954; Kuznets, 1955).

These approaches posited that, in the early stages of development, economic growth and income distribution involved a trade-off. This conclusion was in part derived from the famous inverted U-curve hypothesis of Kuznets, which was designed to provide a general framework for understanding patterns of inequality as modern economic growth induced substantial increases in the average incomes of nations (Kuznets, 1955).

The hypothesis was based on two initial assumptions: a significant income gap between rural agriculture and urban industry; and greater inter-sectoral inequality within urban industry than within rural agriculture. As the labour force migrated from labour-surplus agriculture to labour-demanding industry, the weight of the sector with greater inequality increased while the gap between the two sectors was also likely to rise. As a consequence, overall inequality would at first rise and then stabilize for some time before falling.[6] But why would inequality fall? For Kuznets, inequality "eventually diminished because of the rising economic and political bargaining power of the lower-income groups after the initial dislocation of the Industrial Revolution, and after they had become more established urban residents and more organized [...] and it was this social transformation that was the basis for a trend break in the income distribution of a country" (McKinley, 2009:13).

If economic growth and income distribution involved trade-offs, then the policy implications of Kuznet's hypothesis were also clear. Development policy was to concern itself with economic growth. Distributional concerns were hence sidelined. This emphasis on economic growth was reinforced by other studies that showed that capitalists had a higher propensity to save than workers, so a redistribution of income towards profits would raise the growth rate (Kaldor, 1957; Goodwin, 1967). In other words, income inequality would do more good than harm to economic growth.

But was Kuznets correct? Was there an inevitable trade-off between growth and income distribution? These then became the questions that preoccupied empirical studies for the next few decades. Two issues were of concern here: the impact of growth on income distribution and the impact of income distribution on growth.

Cross-country empirical investigations suggested that growth had neither a positive nor a negative effect on inequality (Anand and Kanbur, 1993; Deininger and Squire, 1996; Ravallion and Chen, 1997; Easterly, 1999; Dollar and Kraay, 2002). Widening inequality in different countries was associated with very different growth paths. In some countries, rapid economic growth was accompanied with rising inequality, whereas, in others, inequality rose during periods of stagnation and depression. Recognizing this diversity of country experiences was perhaps the most important lesson to be learned from the data. "At the very least, it shifts attention away from an unquestioning suspicion of high growth rates as such towards an examination of the particular nature of growth in different countries and the implications of different types of growth for inequality" (Kanbur, 2011:8).

What about the impact of inequality on growth? For some, rising inequality dampened growth. When credit-worthy borrowers cannot borrow because they lack collateral, then their lack of income or wealth limits their

Box 1.1. Definitions of income inequality

Income inequality: Measures the distribution of income across households or individuals in an economy. This is usually measured using the Gini Index of inequality which varies between zero and 100, with zero reflecting complete equality and 100 indicating absolute inequality. Another commonly used measure is the income share ratio, which presents the ratio of the average income of the richest quintile of the population divided by the average income of the bottom quintile. This ratio can also be calculated for other percentiles, such as deciles.

The analysis of income inequality in this report focuses mostly on the distributions of income across two dimensions:

1. **Household income distribution:** This is the distribution of income across households within the economy. Inequality of household income distribution can in turn be decomposed as follows:
   i. **Primary income distribution:** The distribution of household incomes consisting of the (sometimes cumulative) different factor incomes in each household **before** taxes and subsidies, as determined by markets and market institutions.
   ii. **Secondary income distribution:** The distribution of household incomes **after** deduction of taxes and inclusion of transfer payments.
   iii. **Tertiary income distribution:** The distribution of household incomes when imputed benefits from **public expenditure** are added to household income after taxes and subsidies.
2. **Functional income distribution:** This is the distribution of income between different factors of production, such as land, labour and capital. It is typically measured as the share of wages or profits in national income.

Source: *Atkinson (2009) and van der Hoeven (2008).*

ability to invest — in small businesses, their farms, and in the health and education of their children (Alessina and Rodrik, 1994; Perotti, 1996). Thus, high inequality could exacerbate the effect of capital and other market failures on growth. Other studies found no link (Barro, 2000; Lopez, 2004). Over time, however, more and more analysts moved to the view that an initial condition of greater asset and income equity enhances growth rates.

Even as empirical work began to discard the earlier growth and distribution trade-off conclusion,[7] the early literature highlighted two issues that remain relevant for policy today. First, since growth and income distribution are organically linked, income inequality cannot be moderated without addressing the structure of growth and, more specifically, the distributional bias of growth. Second, precisely because growth and distribution are inseparable, it cannot be assumed that policy drivers impacting growth will not impact income distribution. Put differently: if income inequality is rising, this points to a distributional bias in the growth process. Thus, policies to moderate income inequality will have to modify the structure of growth. Specifically, the structure of growth will have to influence the pattern of income distribution in such a way that a larger segment of society can share in the overall progress of the economy.

But since the determinants of growth and income distribution are not mutually exclusive, policy makers cannot independently address growth, as that can run the risk of unwittingly and adversely affecting income distribution (Kanbur and Lustig, 1999). Indeed, as noted earlier, individual policy instruments can have growth and distributional consequences. For instance, policy instruments that are assumed to be exclusive to growth, such as government expenditure and trade and financial openness, are not necessarily exclusive to growth. Government expenditures and trade and financial openness have been found to be positively correlated with growth, but negatively with equality (Lundberg and Squire, 1999).

It should also be emphasized that, since distribution concerns who gets what, the 'who' that the early development literature was concerned with was the share of national income accruing to labour and capital — that is, the functional distribution of income[8] — and how this distribution affected savings, the accumulation of capital and growth. By showing how growth and functional income distribution were organically linked — that is, that "the evolution of one is intimately tied to the evolution of the other" (Lewis, 1954) — the literature underscored the fact that growth mattered not simply for functional income distribution, but also for personal income distribution.

By the late 1990s, as poverty rates rose to alarming levels, attention focused squarely on personal income distribution and especially on the incomes of those at the tail end of distribution. Income inequality now mattered insofar as it mattered for poverty reduction.

1.2b. Pro-poor growth approaches

Pro-poor growth frameworks were concerned with three differentiable, but connected development objectives: poverty, inequality and economic growth, of which the principal objective was poverty reduction. The main means of promoting poverty reduction were faster growth and greater equity (including an initially lower level of inequality and a reduction in inequality). Faster growth would lead to absolute improvements for all, while greater equity implied relative improvements for the poor (compared to the state of the non-poor). It was possible to achieve the first without the second or the second without the first.

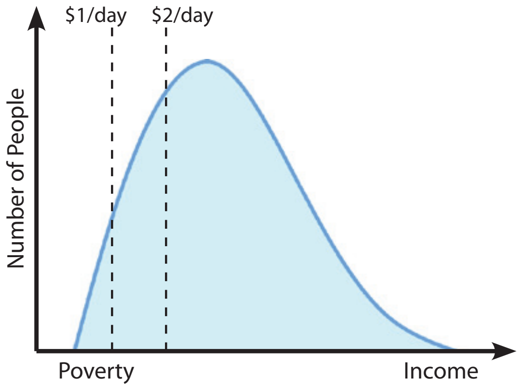
These differences lay at the heart of the debate on pro-poor growth, with the two sides differing on how pro-poor growth should be defined and characterized. On the one hand, it was argued that, insofar as there was an absolute increase in the per capita incomes of the poor, economic growth would reduce poverty (Ravallion, 2004). Simply put: insofar as growth resulted in a reduction in an absolute reduction of the number of poor households, it could be characterized as pro-poor. Thus, even if inequality were rising, growth could be pro-poor (insofar as poverty was falling). On the other hand, it was argued that growth could be pro-poor only if the incomes of the poor grew faster than those of the non-poor (Kakwani et al., 2004). In other words, growth could only be considered pro-poor if it led to a fall in relative poverty, which implied a reduction in inequality (Figure 1.2).

Thus, the differences between the two approaches depended on whether poverty was defined in its absolute or relative sense. And these differences led both sides of the debate to a different emphasis on policy instruments that could be effective in reducing poverty. While faster growth would lead to absolute improvements for all, greater equity implied relative improvements for the poor (compared to the non-poor).

Over time, both approaches converged and agreed that, if the development objective were poverty reduction, then faster growth and greater equity should be policy priorities. Put differently: poverty reduction could be achieved through (1) faster growth without necessarily improving equity, (2) improving equity even if growth rates remained the same, or (3) a combination of faster growth and improving equity (McKinley, 2010).

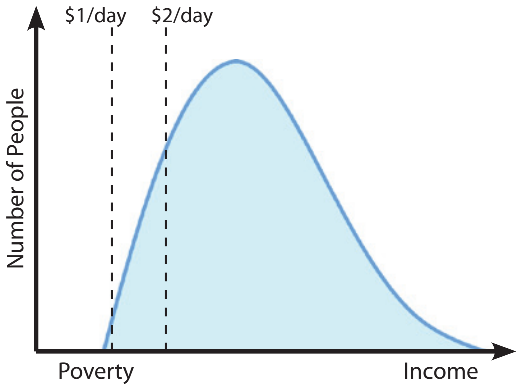
But if growth and equity were means of addressing poverty, then, as policy instruments, improving equity was neither less nor more important than accelerating growth. Furthermore, if one could mix and match

Figure 1.2. Pro-poor growth: absolute and relative definition



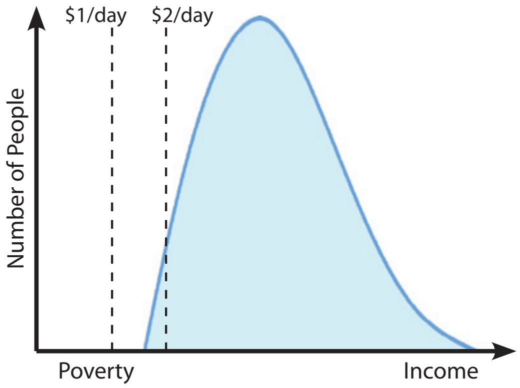
Income distribution in a developing country with a large incidence of poverty

Income is very unevenly distributed, with many people struggling with incomes below the poverty line.



Pro-poor growth: Absolute definition

The poor benefit from growth in the economy, but there is no change in income distribution.



Pro-poor growth: Relative definition

Through strategic efforts, the growth in the incomes of the poor is higher than in the rest of the economy, thus reducing both poverty and inequality.

both means (i.e., faster growth and greater equity), then growth could be pursued without fear of changes in income distribution and/or vice versa.

However, as noted earlier, distribution and growth are intrinsically linked, so individual policy instruments that influence growth can also influence distribution. "Individual policy instruments can be highly distributionally non-neutral, even though some combination of them can of course lead to distribution neutral growth" (Kanbur and Lustig, 1999:8).[9]

In other words, by assuming an implicit separability of policy instruments between growth and equity, pro-poor growth approaches reinforced the idea that growth could somehow be accomplished through a set of policy instruments independently of redistribution. "There was a danger of an easy slip into a classification of policy instruments into growth instruments (such as lower tariffs, higher foreign direct investment, and privatizing state-owned enterprises (SOEs) and redistributive instruments (such as food subsidies, labour-based public works, and progressive taxation)" (Kanbur and Lustig, 1999:8).

Furthermore, if equity could improve even as growth rates remained unchanged, this implied that "equity could be achieved simply by redistributing income, without altering the basic structure of an inequitable distribution" (McKinley, 2009:18). Yet this, too, was a problematic assumption, since high inequality could lower the rate of growth, which, in turn, could reduce the amount of tax revenue available for redistribution. Moreover, there could be political and economic limits to redistribution: if growth continued to worsen the primary distribution of income, governments would be under pressure to continually expand their redistributive role just to maintain the same level of equity. Yet there were limits to how much governments could increase the level and progressivity of taxation, since raising taxes could itself undermine growth.

By the early 2000s, the debate on pro-poor growth stalled and the concept of inclusive growth started gaining currency in development circles as the traditional focus on addressing extreme poverty was regarded as too limiting. There was widespread recognition that wealth and income inequalities were rising in many developing countries, adversely affecting large segments of the non-poor population.[10] Furthermore, policy makers came under pressure to respond to the needs of a much broader segment of the population.

1.2c. Inclusive growth frameworks

Broadly speaking, inclusive growth refers to equity with growth or to broadly shared well-being resulting from economic growth. Different approaches to inclusive growth differ with respect to how inclusive growth should be exactly measured. For some, inclusive growth is "growth that builds a middle-class, which implies an increase in both the proportion of people in the middle-class and the proportion of income they command" (Birdsall, 2007:262). Others measure inclusive growth with reference to the income share of the poorest 60 percent of households (McKinley, 2010). Yet others use inclusive growth as a measure to determine whether economic opportunities created by growth are available to all — particularly the poor — to the maximum extent possible (Ali and Son, 2007). In this Report, inclusive growth is defined as growth that is accompanied by lower income inequality, so that the increment of income accrues disproportionately to those with lower incomes (Rauniyar and Kanbur, 2010).

Despite differences among various approaches on how inclusive growth is to be exactly measured, the chief concern in all of these approaches is with extending disproportionate benefits of growth to a wider share of the population. This is in contrast to pro-poor growth frameworks where the central concern was with raising the incomes of poor households relative to the rest of the population. For advocates of inclusive growth, growth and equity instruments could be used to improve income distribution. However, two issues were critical for determining the optimal policy mix:

(1) The interplay between inequality and growth

(2) The interplay between inequality and poverty

Since changes in inequality are linked to changes in growth (or the structure of growth), it would be essential to ensure that growth is associated with a disproportionate increase in the incomes of those lower in the distribution curve. Thus, it would be important to identify policies that alter the distributional bias of growth while maintaining (or raising) long-term growth. Since growth and inequality are not bound in some immutable relationship, other factors (e.g., policies, institutions, external conditions) could all be more important in determining the wide range of observed outcomes in the relation between growth and inequality. Hence, the focus should be on policies and institutions that influence the joint evolution of equality and growth and not on the rate of growth *per se*.

Income and wealth inequality matter for inequality in non-income aspects of well-being. But, as many have cautioned, it would be a mistake to assume that income or wealth could alone be sufficient to explain the persistence of inequality for other (non-income) aspects of well-being.

Furthermore, changes in inequality could also have a bearing on poverty outcomes. For instance, if inequality fell, there could be a range of possibilities for distributional change associated with any given growth rate. In other words, inclusiveness itself could be more or less pro-poor because certain types of inequality decrease (such as those that raised middle-level incomes) would reduce poverty by less than other types of inequality decrease (such as those that raise the lowest incomes). In other words, it was important to ask the question: redistribution from whom to whom? This was important from a policy perspective because, if poverty reduction was the objective, then the focus must be on "growth with as much inclusiveness of the poorest as possible" (Rauniyar and Kanbur, 2010:8).

To conclude, this review of the development literature on income inequality pointed to the importance of economic growth and structural factors in determining outcomes that matter for human well-being. The evidence indicated that there is no immutable trade-off between growth and income inequality and pointed to the importance of focusing on the functional distribution of income in order to influence income inequality at the household level.

Further, given the organic connection between growth and inequality, these frameworks stressed the importance of not assuming an implicit separability of policy instruments for growth and inequality.

That income inequality was a key determinant of inequality in other dimensions of well-being such as health and education was borne out by the evidence. "In developing countries, 40 percent of children in the poorest wealth quintile are underweight, compared to 15 percent in the richest. […] Data from 43 developing countries indicates that 90 percent of children in the richest wealth quintile attend school, compared to 64 percent in the poorest quintile. […] On average under 5 mortality rates are more than twice as high among children from the poorest wealth quintile as among those from the richest" (UNICEF 2010:2-3).

Clearly, income and wealth inequality matter for inequality in non-income aspects of well-being. But, as many have cautioned, it would be a mistake to assume that income or wealth could alone be sufficient to explain the persistence of inequality for other (non-income) aspects of well-being. Public policies that biased public expenditure patterns to infrastructure and services that benefited more developed regions in a country; the macroeconomic and budgetary policies that resulted in regressive fiscal schemes; or an insufficient allocation of resources to primary social services also explained why progress towards more equitable outcomes in these aspects of well-being had failed. Governance deficits manifest in corruption, the lack of any proper accountability and inadequate institutional capacities all contributed to the persistence of inequality in non-income aspects of well-being.

Moreover, the persistence of unequal outcomes for specific groups in the population (women, racial and ethnic minorities) indicated that factors other than income were also generating unequal outcomes.

These, then, were the issues and concerns that guided the development literature focusing on inequality in opportunities.

1.3. Inequality of opportunity

1.3a. The human capability approach

By the late 1970s, development discourse moved beyond a narrow concern with income inequality.[11] The pioneering work of Amartya Sen very fundamentally reframed the discussion of inequality in development (1979, 1992, 1997, 2003). Now, inequality was examined in the context of human capability.

According to Sen, an overwhelming concern with income and economic growth as the objective of development confused the means and ends of what development was about. It took the form of "focusing on production and prosperity as the essence of progress, treating people as the means through which that productive process is brought about rather than seeing the lives of people as the ultimate concern and treating production and prosperity merely as means to those lives" (Sen, 2003:41).

Sen argued that the primary objective of development should be the enrichment of people's lives — the quality of their lives, their well-being. The notion of well-being was captured by the concept of capabilities. The term referred not simply to what people were able to do, but to their freedom to lead the kind of life they valued or had reason to value. In short, capabilities are the capacity and freedom to choose and to act (Sen, 1997).

What constituted the set of capabilities, however, was complex, since the things that people value doing or being (i.e., their functionings) could be quite diverse. Moreover, determining what constituted this set could not be unrelated to underlying social concerns and values, since that context decided which functionings and capabilities may be important and others trivial or negligible. Thus, the set of functionings and capabilities could include such elementary functionings as escaping morbidity and mortality and being adequately nourished to more complex functionings such as achieving self-respect and taking part in the life of the community (Nussbaum and Sen, 1993; Nussbaum, 2000).

This approach to the evaluation of well-being had bearings on many exercises, including discussions on inequality. According to the capability approach, an excessive concentration on inequalities of income or wealth cannot adequately account for inequalities in the quality of life. "Inequality of wealth may tell us things about the persistence and generation of inequalities of other types, even when our ultimate concern may be with inequality in living standard and quality of life. Particularly in the context of the continuation and stubbornness of social divisions, information on inter-class inequalities in wealth and property ownership is especially crucial. But this recognition does not reduce the importance of bringing in indicators of quality of life to assess the actual inter-class inequalities of well-being and freedom" (Sen, 2003:52).

In other words, the inequality of income could only inadequately explain inequality in people's capabilities. "The problem of concentrating on inequality of incomes as the primary focus of attention is that the extent of real inequality of opportunities that people face cannot be deduced from the magnitude of inequality of incomes, since what we can or cannot do, can or cannot achieve, do not depend just on our incomes but also on a variety of physical and social characteristics that affect our lives and make us what we are" (Sen, 1992:28). In short, the problem with focusing on equality of incomes was that everyone's income was treated as symmetric regardless of the difficulties some people faced compared to others in converting incomes into well-being and freedom.

The emphasis in the capability approach was on having the freedom to choose one kind of life rather than another—not on incomes, especially since the relationship between income, on the one hand, and individual achievements and freedom, on the other, appeared to be highly variable and dependent on "contingent circumstances, both personal and social" (Sen, 1971:70). These "circumstances" included:

Personal heterogeneities: People have physical characteristics connected with age, gender or disability that made their needs diverse. For instance, an ill person even with higher expenditure on treatment or care may not be able to improve health outcomes.

Environmental diversities: Environmental diversities such as climactic conditions (rainfall or flooding, for instance) could influence what a person could get from a given level of income.

Variations in social climate: The translation of personal incomes and resources into functionings could be influenced by societal conditions, including public health care, public educational systems, the prevalence or absence of crime in a particular location and the nature of community relationships (social capital).

Differences in relational perspectives: The material requirements associated with established patterns of behaviour could vary between communities, depending on customs and convention. To 'appear in public without shame', for instance, could require higher standards of clothing in one society or community compared to another.

Distribution within the family: The intra-household distribution of income could be a crucial factor linking individual achievements (outcomes) and opportunities with the overall level of family income.

According to Sen, these "circumstances" helped to explain the variability between incomes and other substantive achievements such as being healthy, being well-nourished, participating in the life of the community and so on. Furthermore, since people's abilities to activate these primary goods varied, the importance of looking into "the actual living that people manage to achieve" was emphasized. Put differently: the emphasis was on securing a real opportunity for every individual to achieve the functionings that he or she desired. Sen thus answers the question of inequality of what by advocating his preferred notion of equality, which is based on the capability for functionings.

The contribution of the human capability approach to the development discourse on inequality was and remains hugely influential. By arguing that equal incomes may not translate into a more equitable level of human capabilities, he emphasized that the opportunities that gave individuals the freedom to pursue a life of their own choosing needed to be equalized.

Box 1.2. Horizontal inequalities

While Sen moves away from a focus purely on incomes to incorporate wider perspectives on well-being, the emphasis of his approach lies on the individual. Others, such as Frances Stewart, have made the case for being concerned with inequalities across groups, i.e., with horizontal inequalities. Horizontal inequalities are inequalities between groups with specific characteristics that their members and others recognize as important aspects of their identity (Stewart, 2002; Stewart et al. 2007). These groups could be defined by cultural, gender, ethnic, religious, racial, geographic location, or age, among other characteristics.

Horizontal inequalities or group-based inequalities are the result of systematic discrimination and exclusion that typically results from stereotypes and prejudice (Stewart and Langer 2007; Stewart et al., 2010). There are a number of reasons to be concerned about group inequalities. They can prevent individuals within marginalized groups from achieving their full potential and contributing to their society's prosperity. Furthermore, they may affect that individual's welfare directly by impacting the respect and wellbeing of the group with which the individual identifies.

Horizontal inequalities manifest themselves in unequal opportunities and outcomes across socio-economic, political and cultural dimensions. Within the socio-economic dimension, for example, restrictions to land ownership or inheritance for women or disproportionately low-quality health services for racial minorities living in remote areas result in unequal opportunities and outcomes for specific groups. Factors within the political dimension range from restrictions for specific groups to access to political leadership positions, to disproportionately low percentages of women in the police force. The dimension of cultural status includes factors such as limited recognition of minority languages or restriction of ethno-cultural practices.

Equal incomes indeed may not translate into an equal capability for functionings, but it is also true that extreme income inequality can limit opportunities for advancement or limit opportunities to secure capabilities that may be necessary to lead a good life. If the market economy could systematically produce dis-equalizing outcomes that effectively excluded or compromised participation of a variety of social classes and groups, then it could not be counted on to provide the space where the equality of fundamental freedoms could be established. "The capability approach does not of itself address the systemic impediments to human freedom that are associated with the functioning of market economies" (Dean 2009:9). By focusing on the equality of opportunities, the dynamics that connect opportunities and outcomes in the context of a market economy are left outside the analysis.

Furthermore, recent studies on social stratification in market economies have shown that material benefits from gender and racial inequality "rebound to dominant groups, who therefore have an incentive to reproduce conditions of inequality" (Darity, 2006). In other words, inter-group inequality can be "intentionally structured to extract rents" and dominant groups can develop and sustain processes that generate social hierarchies and status differences (Seguino, 2008).

Ideology, cultural beliefs, norms and stereotypes then justify a given distribution of resources and the resulting social hierarchy. Thus, status and power hierarchies derive from the dominant group's superior control over material resources. That control and the resulting power differential motivate dominant groups to continue this hierarchical system based on social stratification.

The social sphere then sits alongside the material structure of power relations. But since the principal focus of the human capability perspective is 'individual freedom', it does not of itself challenge the relations of power

Equal incomes indeed may not translate into an equal capability for functionings, but it is also true that extreme income inequality can limit opportunities for advancement or limit opportunities to secure capabilities that may be necessary to lead a good life.

that underpin inequality in a market economy. It appears instead that the individual is "objectively distanced from the relations of power within which his or her identity and his or her life-chances must be constituted" (Dean 2009:8).

1.3b. Equity approach

One of the approaches inspired by the human capability perspective was that of equity. The principal concern of this approach was on eliminating disadvantage from circumstances that lie beyond the control of the individual but that powerfully shape both the outcomes and the actions in pursuit of those outcomes (World Bank, 2006).

Equity was seen to have intrinsic value[12] since some groups faced consistently inferior opportunities—economic, social and political—than their fellow citizens. This violated the principle of fairness, particularly when the affected individuals could do little about them. Specifically, equity was defined in terms of two basic principles. First was equal opportunity, i.e., the idea that a person's life achievement should be determined primarily by his or her talents and efforts, rather than by predetermined circumstances such as race, gender, social/family background or country of birth. The second principle was the avoidance of extreme deprivation in outcomes, especially in health, education and consumption levels.

It was argued that the absence of equal opportunities was damaging because political, economic and social inequalities reproduced themselves over time and across generations, resulting in inequality traps. These traps had two implications: first, because of market failures and of the ways that institutions evolve, inequality traps affected not only distribution, but also the aggregate dynamics of growth and development. For instance, due to informational asymmetries, some people with good ideas could end up constrained in their access to capital. Thus, these differences in initial endowments—such as family wealth, race, or gender—could cause market failures and make investment less efficient. Second, the functioning of states, legal systems and regulatory agencies is influenced by the distribution of political power (or influence, or voice) in society. Thus, unequal distributions of control over resources and of political influence could perpetuate institutions that protected the interests of the most powerful. Consequently, those whose rights were not protected would have little incentive to invest, a situation that would thereby reproduce inequality.

Disparities in opportunity hence translated into different abilities to contribute to a country's development. Thus, apart from the intrinsic value of equity, there were also instrumental reasons to be concerned about inequality. "The sharing of economic and political opportunities is also instrumental for economic growth and development."[13] In other words, equity and growth need not involve trade-offs. Equity could be complementary to long-term growth. The policy focus of the equity approach centred on three pillars that would help promote a level playing field: investing in human capital; expanding access to justice, land and infrastructure; and promoting fairness in markets.

By investing in human capital, potentially talented and productive individuals would gain access to services that they may have been excluded from for reasons that had nothing to do with their potential and societies would gain from greater efficiency and greater social cohesion in the long run. Achieving more equal access to markets was also seen as fundamental for greater equity. "The playing field is far from level in the workings of the market. Barriers are intrinsically inequitable when they privilege insiders' access to capital, good jobs and favoured product markets. But they are also bad for innovation and investment that lie at the heart of modern economic growth. This is why levelling the playing field has the potential to be more equitable and efficient" (World Bank, 2006:178). Hence, improving access to finance and financial services, labor market interventions[14] and interventions in product markets were all seen to be essential for greater equity.

While more even playing fields were likely to lead to lower inequalities in educational attainment, health status and incomes, it was argued that one would always expect to find some differences in outcomes owing to differences in preferences, talents, efforts and luck. This is consistent "with the important role of income differences in providing incentives to invest in education, to work and take risks" (World Bank, 2006). The principle of equal opportunity hence implied that each person's prospects depended only on his or her resources and willingness to exert effort (Pignataro, 2011). This is why equal opportunity theorists aimed to identify the things that a person should be held responsible for and the unchosen circumstances that a person does not have control over. Only inequalities stemming from unchosen factors must be removed. But are established economic arrangements and market forces within an individual's control? Do not economic arrangements also influence the way talents and efforts are rewarded by society? Can the processes that determine income inequality be modified with equal opportunities? Can opportunities be secured when incomes are falling? In fact, if real incomes are falling, the idea that anyone can make it through hard work and effort appears increasingly dubitable. As incomes have stagnated or fallen, so have opportunities. Extreme income inequalities can put to rest the idea that a good life can be had by all.

For the equity approach, insofar as outcomes mattered at all, they mattered only in cases of ***absolute deprivation***. The implication of this principle was that societies may intervene to protect the livelihoods of their neediest members, i.e., those falling below an established threshold of need. However, establishing that threshold of need is fraught with problems. Depending on where the poverty line is set, the number of households 'absolutely deprived' can change dramatically. For instance, if the poverty line is US$1 a day, the absolute number of poor decreased from 1.47 billion in 1981 to 0.97 billion in 2004. However, if the poverty line is defined as US$2 a day, the absolute number of poor increased in every nation outside East Asia (Ferreira and Ravallion, 2009).

Nor can absolute poverty measures disclose what happened to people after they crossed the given poverty line. Is the future income of a person exiting extreme poverty US$5 a day or US$1.01? Does a person with an income of US$1.01 have real opportunities to climb further in the income distribution if he or she so desires? Or will he or she face systematic limitations along the way? A narrow focus on the reduction of absolute poverty can thus lead to the idea that distributional policies are unnecessary to achieve a socially just development process.

More important, despite an explicit focus on ensuring the 'fairness' of processes that determine material outcomes, this perspective is unable to account for the intransigence of discrimination even though overt forms of racism and sexism have become more socially unacceptable and even as explicit bias has been virtually eradicated in several countries. By making the case that discrimination and prejudice violate the intrinsic value of the principal of fairness, the instrumental role of prejudice — that of maintaining inter-group hierarchies and functioning "as a social weapon to support the dominant group's preservation of its superior position"—is sidelined (Darity et al., 2006).

The recent literature on social stratification provides a rich approach to improving the understanding of group-based inequality, such as between ethnic and racial groups. According to stratification theory, the foundation of prejudice finds its anchor in relative group status. Furthermore, prejudice becomes fully activated when members of the dominant groups come to believe that members of the subaltern group desire their privileges and are mobilizing or mobilized to threaten their proprietary claims. Relative group position as the basis for prejudice thus directs attention to inter-group dynamics and differentials in power between groups. It directs attention to the fact that discriminatory social ideologies and norms are embedded in institutions and codified by public policy. Power permits elites to shape ideology, norms and stereotypes as well as formal social institutions in such a way that it defines the dominant group's activities and traits as superior and more valuable. But equal opportunity proponents ignore this more instrumental role of prejudice.

The recent literature on gender inequality also points to the importance of social stratification — that is, hierarchical social and economic relations — based on accentuated differences between men and women that in turn shape a gender division of labour. In most societies, the gender division of labour favours men's access to and control over resources. Women are constrained from engaging in resource-generating activities outside the household. "Status and power hierarchies derive from men's superior control over material resources. That control and the resulting power differential provide the motivation for men to continue this hierarchical system based on gender differentiation" (Seguino, 2008:9).

Male power permits men to shape ideology, cultural norms and stereotypes in a way that defines men's activities and traits as superior and more valuable than women's. To the degree that women choose to comply with gender norms, men need not employ their power to maintain the status quo.

However, as several studies have shown, the degree of gender stratification varies positively with the level of women's economic power. Furthermore, the state of the macroeconomy influences women's bargaining power within the home since it affects women's outside options. For example, the overall demand for labour coupled with the types of jobs that women can get or can produce has a positive effect on women's status within the household. Thus, improvements in women's well-being require permitting women greater access to and control over material resources (Seguino, 2008).

In other words, "livelihood inequality buttresses other forms of gender inequality — such as health, education, bodily integrity, and dignity. Thus, livelihood equality is a pivotal change target in order to transform a comprehensive stratified gender system into one that is gender equitable. In short, equity — equality of opportunities — requires equality of outcomes" (Seguino, 2008).

1.4. Beyond outcome or opportunity inequality

Outcomes and opportunities are clearly closely interrelated. Providing only equal opportunities is unlikely to enhance the well-being of disadvantaged groups if income inequalities are rising at the same time. When children of the rich can go to college without accumulating massive debts or have access to quality health care, it is difficult to argue that incomes do not matter for opportunities to get ahead in life. The assumption that a just outcome can derive from an unjust starting point is dubitable.

Furthermore, poor outcomes beyond income also undermine opportunities. Where outcomes are highly unequal among parents and caregivers, this inequality is transmitted to children, compromising the opportunities of the next generation (UNDP, 2010; Save the Children, 2012). Evidence shows, for example, that differences in birth weight, determined in large part by maternal nutrition, are directly correlated with young child survival, stunting, and educational achievements (Behrman and Rosenzweig, 2004; Woodhead et al., 2012).

But inequalities in opportunities are also critical for three reasons: First, they can magnify the distributional consequences of factors that drive income inequality. For instance, inequality in education is a major contributor to the inequality of income and the same is true for health. Second, without equal opportunities, it will be difficult to tackle horizontal or vertical inequality. Third, equal opportunity has intrinsic value.

The conversion of equal incomes into equal capabilities for functionings was mediated by a host of other factors: governance, the role of public policy and societal conditions, among others.

Thus, any sustained reduction in inequality will need to address both — the inequality of outcomes as well as the inequality of opportunities.

Perspectives focusing on the inequality of outcomes (income inequality) emphasize the idea that income is the single factor that has the greatest impact on people's living conditions. Indeed, this literature was mainly focused on examining how patterns of economic growth were linked to income distribution and how high and rising income inequality reflected a distributional bias of the growth process. The literature pointed to the importance of addressing income inequality, as high inequality could undermine growth itself and slow the rate of poverty reduction. So, those most in need of equitable outcomes would be least likely to get there in the face of rising inequality. Moreover, by pointing to the links between functional and primary income distribution, the literature pointed to the importance of structural drivers and macroeconomic policies in determining individual welfare outcomes. In addition, by highlighting the role of functional and primary income distribution, the literature pointed to the fact that employment in decent jobs is itself an effective distribution mechanism.

But still — and this was Sen's valuable insight — higher income levels (or, for that matter, symmetric incomes) were unlikely to translate into more equitable outcomes (as reflected in better levels of education or health) or into an equal capability for functionings. The reason for this was that the conversion of equal incomes into equal capabilities for functionings was mediated by a host of other factors: governance, the role of public policy and societal conditions, among others. This, then, was one limitation of focusing only on inequality of outcomes. Other factors, too, mattered for equal opportunity.

A second limitation of development approaches to income inequality was their inability to explain the persistence of inter-group inequalities in outcomes. For instance, the underrepresentation of a subaltern group in high-status occupations and professions is typically characterized as a 'pipeline' problem — an inadequate supply of individuals from the relative group with the appropriate credentials. But the persistence of discrimination is evidenced by the fact that, even after accounting for 'observable characteristics', substantial income differentials persist, with women, racial and ethnic minorities consistently falling at the lower end of income distribution.

On the other end, advocates of the equity approach correctly emphasized the fact that, without equal opportunity, equitable outcomes cannot be secured. But they left the dynamics that connected opportunities to outcomes in a market economy unexamined. These remain far from equitable. By focusing exclusively on building an individual's basic capabilities and ensuring equitable access and opportunity, the assumption was that “a greater supply of better-qualified job seekers (in terms of education, housing and mobility) will automatically stimulate the demand to employ it” (Amsden, 2010). However, the expectation that more job seekers who are qualified will generate the demand to employ them is especially irrational in market economies. It requires a leap of faith to assume that, with better opportunities for health care, education and training, poor households and disadvantaged groups can attract the demand necessary to earn a living wage either by working for others or by employing themselves as entrepreneurs.

Importantly, despite the fact that this perspective is mainly concerned with how systemic patterns of discrimination can prevent disadvantaged groups from accessing resources, markets and public services, it was still unable to explain the intransigence and persistence of unequal outcomes for disadvantaged groups even when most laws that explicitly codify discrimination have been stricken from the books. But, as the literature on social stratification has pointed out, power inequalities imply that the dominant group is able to extract compliance from subordinates. The tools of extraction include the material dependence of the subordinate group on the dominant group, a set of ideology, norms and stereotypes to regulate everyday behaviour, and overt forms of power, including violence.

It requires a leap of faith to assume that, with better opportunities for health care, education and training, poor households and disadvantaged groups can attract the demand necessary to earn a living wage either by working for others or by employing themselves as entrepreneurs.

Indeed, as pointed out by studies on gender inequality: the system of gender inequality acts as a ‘conversion factor’ discounting the extent to which women can convert incomes and other resources into capabilities and power. That system is undergirded by a gender ideology that justifies the unequal state of gender relations, socially and materially. It is supported, monitored and enforced by gender stereotypes and norms. These, in turn, are embedded in a variety of institutions, including property laws and labour markets. The material and cultural spheres operate in tandem, each influencing the other to produce and reproduce systemic gender inequality (Seguino, 2008).

However, if human well-being is about the real (i.e., materially feasible) freedom to choose the kind of life one has reason to value, then this emphasis on real freedoms underscores the idea that “outcomes in material wellbeing are the means required to achieve this freedom, as compared to a mere legalistic approach, which instead accentuates procedural freedoms such as the right to property or education” (Seguino, 2008).

Transcending the artificial dichotomy of outcome or opportunity inequality is especially important because of its implications for development policy. Four issues deserve specific mention in this context:

- Achieving equal opportunity will require moderating income inequality between households, with a specific focus on those at the lower end of distribution, and on specific, disadvantaged groups within the population.
- Although income inequality is significantly correlated with inequality in non-income aspects of well-being, incomes are not the sole determinant of inequality in non-income outcomes. Improving inequalities in the non-income dimensions of well-being will require addressing those characteristics of policies, institutions and governance processes that prevent equitable outcomes in health, nutrition and education from being achieved.

- Even as issues of equal access, anti-discrimination legislation and policies (such as affirmative action) will be needed to promote equal opportunity and level the playing field, addressing inter-group inequality will require more fundamental interventions such as strengthening and empowering the agency, voice and participation of groups who remain consistently excluded from opportunities.
- Finally, cultural stigmas and systems of prejudice and discrimination that remain embedded in public policy and political economic and social institutions will need to be addressed.

1.5. Conclusion

This chapter has reviewed development perspectives concerned with the various dimensions of inequality that matter for human well-being and how variations in well-being are distributed among individuals, households and groups. Even as human well-being is multi-dimensional and arises from the interplay between a person's material, cognitive (subjective) and relational conditions, the development discourse has largely focused on defining and measuring inequality in the material domain of well-being.

More attention must be paid to the subjective and relational domains of well-being and particularly to how these relate in the spheres of human values, norms and behaviour.

Moreover, in this context, the focus in identifying which inequalities matter for human well-being has been on either outcome inequality (as measured by relative deprivations in levels of income or health, nutrition and education, among others) or opportunity inequality (as measured by unequal access to markets or public social services, among others).

The chapter has pointed to the false dichotomy between outcome and opportunity inequality. The two are but opposite sides of the same coin. Hence, development policy focusing on inequality reduction must address both. But inequality is also concerned with who gets what. For some, the 'who' are households that fall at the bottom end of income distribution; for others, it is the entire class of labour. Yet others are concerned with the distribution of outcomes and opportunities by gender or race or ethnicity — and with the stubborn persistence of such disparities across time and space. By pointing to how social norms and stereotypes serve as a powerful means of embedding ideology in social interactions and individual behaviour, they point us to their role as vehicles for the exercise of power. The significance of this is to show that the issue of distribution is at its core a political issue. It involves a contestation over who will get what.

The value, then, of considering relational inequalities (that is, inequalities in voice and agency) is that it demonstrates how deeply intertwined material inequalities are with relational ones. Indeed, improvements in relational inequality cannot be established independently of improvements in the material conditions of well-being.

A human well-being perspective thus encourages us to consider whether efforts to improve the material dimensions of well-being must be accompanied by actions in relation to the other two domains in order to have an overall effect on human well-being outcomes. More attention must be paid to the subjective and relational domains of well-being and particularly to how these relate in the spheres of human values, norms and behaviour.

Such a perspective encourages us to move beyond legal approaches and issues of equal access to a consideration of how to strengthen the ability of disadvantaged individuals and the groups to which they belong to shape decision-making in the productive sphere (such as in the work place) and in the political process. It encourages us to consider empowering individuals and groups to shape their own environment.

How people relate to others and what people feel they can do or be play a strong role in what people will actually do or be able to do. By all accounts, issues of inequality rank highly in people's perceptions of their own well-being (OECD, 2009; Graham and Pettinato, 2001; Chappelle et al., 2009). Many have pointed to inequality as the underlying driver of conflict and social unrest in many countries. "Societal conditions that increase the average level or intensity of expectations without increasing capabilities increase the intensity of discontent" (Gurr, 1970:13; Stewart, 2007). The recent social upheavals witnessed across the developing world are a powerful testimony to this.

Thus, policy makers whose charge is ensuring human well-being must address inequality in all of the dimensions that matter for well-being, focusing especially on those households and groups who remain so consistently on the margins of economic, social and political life.

Notes

1. The conceptual framework on human well-being (and its relation to inequality) is presented in greater detail in chapter 2.
2. This is also why it has been argued that reducing inequalities in health and education will require reducing income inequality (Wilkensen and Pickett, 2009).
3. This perspective — often called the equity perspective — is elaborated upon extensively in the World Development Report 'Equity and Development', World Bank, 2006.
4. Horizontal inequalities are defined as "inequalities among groups with commonly felt cultural identities [and] include ethnic, religious, racial or regional affiliations" (Stewart, Brown and Langer, 2007:4).
5. As Sen himself points out, "The capability perspective differs from various concepts of 'equality of opportunity' which have long been championed. The concept has been used to mean the equal availability of some particular means, or with reference to equal applicability (or equal non-applicability) of some specific barriers or constraints. Thus characterized, 'equality of opportunities' does not amount to anything like equality of overall freedoms" (Sen 1992:7).
6. Neither Lewis nor Kuznets took into account the possibility that the employment effects of low wages during the early reallocation process could, in fact, lead to an increase in the wage bill and a functional distribution favouring labor, which could lead to an improvement in the household distribution of income, as in Taiwan (McKinley, 2010).
7. See Anand and Kanbur, 1993, Li, Squire and Zou, 1998, and Weeks et al., 2004.
8. One exception was Kuznets, whose work focused on personal income distribution.
9. For instance, trade liberalization may have benefited economic growth, but it had adverse consequences for distribution. Government expenditures and financial openness were also positively correlated with growth and negatively with equality (Lundberg and Squire, 2003).
10. Inequality was rising even as countries were making progress in extreme poverty. For instance, the extreme poor as measured by the poverty line of US$1 per day, per person, is projected to decline to only 10 percent of the population in Asia Pacific by 2020 (Ali, 2007).
11. See Paul Streeten, The Frontiers of Development Studies (London, Macmillan, 1972); H. Chenery et al., Redistribution with Growth (London, Oxford University Press 1974); Irma Adelman, "Development Economics: A Reassessment of Goals", *American Economic Review*, 66 (1975); S.R. Osmani, Economic Inequality and Group Welfare (Oxford, Clarendon Press, 1982); Frances Stewart, Planning to Meet Basic Needs (London, Macmillan, 1985).
12. The idea of equity being of intrinsic value is influenced by modern theories of distributive justice that argued that justice implies equality in the allocation of some fundamental concept, whether that be primary goods or liberty, to all people (Rawls, 1958; Roemer, 1996; Sen, 1992).
13. It was pointed out that greater equity would be doubly good for poverty reduction: through the potential beneficial effects on aggregate long-term growth and through greater opportunities for poorer groups within any society (World Bank, 2006).
14. Labor market interventions should level the playing field by "seeking the right (country-specific) balance between flexibility and protection to provide more equal access to equal employment conditions to as many workers as possible" (World Bank, 2006:).

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